IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 356

THE CENTURY INDEMNITY COMPANY,

Petitioner,

—against—

RICHARD L. ROSENBAUM, Trustee in Bankruptcy for Ultimite Corporation, Bankrupt, and GRAYS FERRY BRICK COMPANY,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

SAMUEL GOTTESMAN,
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New York City.

THE COURT PRESS, N. Y. C.

INDEX.

TABLE OF CASES CITED:

OTHER AUTHORITIES CITED:

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RICHARD L. ROSENBAUM, Trustee in Bankruptcy for Ultimite Corporation, Bankrupt, and GRAYS FERRY BRICK COMPANY,

Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

Samuel Gottesman, on behalf of The Century Indemnity Company, prays that a writ of certiorari issue to review the judgment entered in this case on the 7th day of July, 1948, by the United States Circuit Court of Appeals for the Second Circuit reversing an order entered in the United States District Court for the Southern District of New York in favor of the petitioner, directing the trustee in bankruptcy of Ultimite Corporation to turn over to petitioner the sum of $3762.22 out of a fund of $4119.23, in the hands of the trustee, and representing the final payment made by the United States of America under a contract with the bankrupt for certain construction work at Scituate, Mass.

A certified transcript of the record in the case, including the proceedings in the Circuit Court of

Appeals, is furnishd herewith in accordance with the rules of this Court.

An application for rehearing was timely made in the Circuit Court of Appeals and denied by order of that Court filed on July 24th, 1948.

Opinions Below.

The opinion of the Circuit Court of Appeals appears at R., pp. 72-76.

The opinions of the Referee in Bankruptcy, whose orders were confirmed by the District Court without opinion (but which order of the District Court was reversed by the Circuit Court) appear at R., pp. 63-68.

Jurisdiction.

The judgment of the Circuit Court of Appeals was filed on July 7th, 1948 (R., p. 78). The order denying the petition for rehearing was filed on July 24th, 1948 (R., p. 90).

Jurisdiction of the District Court was based on the fact that the proceeding in which petitioner's original application was made was then pending in said Court (Bankruptcy Part). The two orders of the Referee above referred to were confirmed by the District Court. From the said order of the District Court, the respondents appealed to the Circuit Court of Appeals for the Second Circuit.

This Court, by virtue of Subdivision (a) of Section 240 as amended of the Judicial Code (28 U. S. C. A. Section 347) has power and authority, acting upon this petition to require certification, to it, by certiorari, of the cause before the Circuit Court of Appeals, in-

cluding its judgment for purposes of full review and determination.

Statute Involved.

The bond executed by petitioner and under which its rights in this action derive, is known as a Miller Act bond and was required to be filed by Ultimate Corporation, the bankrupt, by 40 U. S. C. A. Section 270(a), which provides, insofar as here material, as follows:

> "(a) Before any contract, exceeding $2,000.00 in amount, for the construction, labor, or repair of any public building or public work of the United States, is awarded to any person, such person shall furnish to the United States, the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as 'contractor'.
>
> * * * *
>
> (2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of which such person * * *."

Questions Presented.

The Circuit Court of Appeals erred:

(1) In failing to decide the rights of petitioner, surety on a bond given pursuant to a federal statute, solely on the basis of the rule of priority enunciated by the federal courts in favor of sureties on this type of bond.

(2) In failing to accord to petitioner the paramount right to the fund in question, accorded to sureties on this type of bond by the decisions of the Supreme Court and of other Circuit Courts of Appeals.

(3) Even assuming that New York State law applies—in failing to decide petitioner's rights on the basis of New York State decisions on similar types of bonds in connection with state construction contracts, in which the New York State Courts have laid down the identical rule of priority as have the federal cases.

(4) In basing its reversal solely on New York State decisions in no way involving the rights of sureties under Miller Act bonds or rights of sureties under similar bonds given in connection with state construction contracts.

(5) In holding that the question of whether the equitable lien possessed by the surety on the fund in question was paramount to the lien of Grays Ferry Brick Co. or the lien of the trusteee in bankruptcy under Section 70(c) of the Bankruptcy Act, must be determined by New York law.

(6) In holding that the trustee in bankruptcy and Grays acquired a lien on a fund which was never the property of the bankrupt.

(7) In holding that if any equitable lien arose in favor of the surety that it would be subordinate to the rights of Grays (the judgment creditor) and the trustee in bankruptcy.

(8) In suggesting that it was questionable whether

any lien that petitioner might have would extend to any amounts other than the reserved percentage on the federal contract in question.

Statement of the Case.

The facts were stipulated and are contained in the Record at pages 36-47. In simple outline, however, they are as follows:

The trustee in bankruptcy is in possession of a fund which represents the final payment made by the government under a contract with the bankrupt for the construction of a building at Scituate, Mass. The existence, identity and tracing of the fund is conceded. No rights of bona fide purchasers for value and without notice are involved. The fund is claimed by petitioner by virtue of its subrogation to the rights of labor and material creditors on the construction contract in question, to whom petitioner made payment under its payment bond and by virtue also of assignments from those creditors. Grays Ferry Brick Co. (the judgment creditor) claims a lien thereon by virtue of a Third Party Order in Supplementary proceedings served by it on the bank in which the fund was deposited before it came into the hands of the trustee in bankruptcy. Grays' judgment was not for any labor or material furnished to the bankrupt in the prosecution of its contract with the government and its Third Party order was served on the bank on the very day on which the bankrupt executed an assignment for the benefit of creditors and one week before an involuntary petition in bankruptcy was filed against it.

The trustee in bankruptcy claims the fund pursuant to Section 70(c) of the Bankruptcy Act which confers

upon a trustee the rights of a creditor holding a lien, or judgment creditor holding an execution returned unsatisfied, as of the date of bankruptcy.

On petitioner's application, the Referee in Bankruptcy held (R., pp. 63-68) that persons supplying labor and materials to a contractor in the prosecution of the work provided for in a government contract, have an original and continuing equitable priority in the moneys payable upon performance of that contract and that the surety on the payment bond of the contractor, upon paying those persons, is subrogated to that right; that the surety's right of subrogation to the superior equities of such labor and material creditors dates back to the execution of its bond; that the weight of authority of the federal decisions on this subject has been followed by the Courts of New York as respects both the surety on a completion bond and the surety on a material and labor payment bond on state construction contracts; that the fund in question was created and in existence, capable of identification before any lien was acquired by the trustee or the judgment creditor, neither of whom is in the position of a bona fide purchaser for value without notice; that the trustee in bankruptcy acquired no rights against the surety; that the only right of the bankrupt to the fund was in any surplus remaining after full payment had been made to labor and material creditors, and that the trustee acquired no greater interest therein; that the surety's right of subrogation to laborers and materialmen in the fund is paramount to the right of the contractor's trustee in bankruptcy and paramount also to the judgment creditor's lien, which if valid, is superior only to the trustee's; that the contention that local law gives a lien creditor precedence over

the subrogated surety has no application to contracts which originated under the Miller Act, and that the contention of the trusteee that payment to the surety would constitute a voidable preference under Section 60(a) of the Bankruptcy Act, has no application here since the statute deals expressly with a transfer of the property of the debtor, and here the bankrupt had no right to the fund except to the extent that a surplus might remain after full payment to labor and material creditors (and to the surety which became subrogated to their rights) and that therefore the bankrupt had no property capable of transfer under the provisions of Section 60(a).

The two orders of the Referee (the second on a motion for reargument) were confirmed by the District Court, but the order of the District Court was reversed by the Circuit Court of Appeals solely on the ground that under New York law the surety's rights are deferred to the liens obtained upon the fund by the judgment creditor and the trustee in bankruptcy.

Reasons for Granting the Writ.

(1) As will be shown in the brief in support of this petition, the decision below is in conflict with the decisions of the Supreme Court and of other Circuit Courts of Appeals in construing the rights of sureties under bonds given pursuant to the Miller Act and its predecessor the Heard Act; it is in conflict with the decisions of other Circuit Courts of Appeals on similar bonds given in connection with state and municipal construction contracts in which those Courts followed the federal rule of priority although contrary to the state rule and, even assuming that New York

law applies to the rights of petitioner (a surety on a bond given pursuant to a federal statute) it is in conflict with all the decisions of the New York State Courts on similar bonds given in connection with state construction contracts in which the New York State Courts laid down a rule of priority identical with that enunciated by the federal decisions in connection with federal construction contracts, and cited those federal decisions as authority for their rulings.

(2) The decision below places the surety on a Miller Act bond in the following incongruous position: The surety's liability under that type of bond is uniform throughout the country because its liability thereunder can only be determined pursuant to federal law. The bond is given pursuant to a federal statute and 40 U. S. C. A. Section 270(b) provides that every suit instituted thereon to recover for labor and materials furnished to the contractor in the prosecution of the contract must be brought "in the United States District Court for any district in which the contract was to be performed and executed and not elsewhere, irrespective of the amount in controversy in such suit * * *." However, according to the Circuit Court's decision in this case, the surety's rights under that bond would depend on the differing rules of priority of the forty-eight states. In the instant case, the work was done in Mass. and all of the creditors to whom the surety made payment were in Mass. (R., p. 47). Yet, because the fund happens to be in New York, the Circuit Court deprives the surety of rights which it might have even on the Circuit Court's interpretation of the law, if the fund happened to be in some state where the local law as regards legal and equitable liens was otherwise; albeit, the New York courts have consistently applied the federal rule of

priority on payment bonds given in connection with state contracts. Aside from the fact that the law is not as stated by the Circuit Court, logic and reason would require that where there is uniformity of liability, there should also be uniformity of right, which is in effect only the reiteration of the rule discussed in Point I of the brief in support of this petition, that where a bond is given and executed pursuant to a federal statute, that only federal law and not local law should control the surety's rights thereunder.

(3) The case is an important one of general interest. It affects all sureties executing Miller Act bonds. The Circuit Court's decision creates doubt and confusion as to the rights of such sureties and upsets what was generally accepted as the law for many years. It overrides decisions of long standing, both of the Supreme Court and of other Circuit Courts of Appeals and tends to throw into chaos the entire field of case law on this type of bond developed throughout the past fifty years.

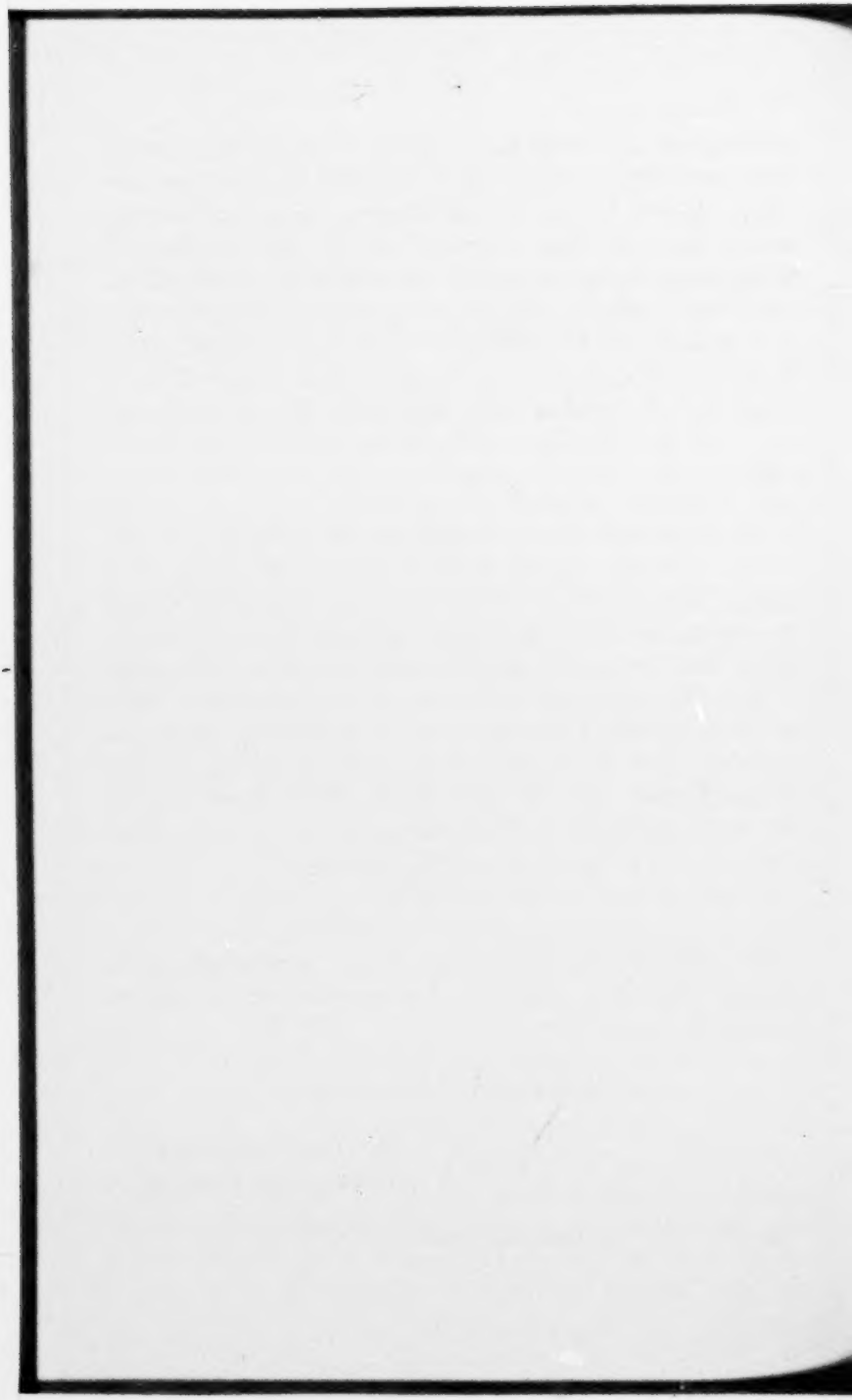
Conclusion.

In view of the foregoing, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

Samuel Gottesman,
Attorney for Petitioner.

New York City, October, 1948.



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RICHARD L. ROSENBAUM, Trustee in Bankruptcy for Ultimite Corporation, Bankrupt, and GRAYS FERRY BRICK COMPANY,

Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Preliminary Statement.

The Referee's opinions which were confirmed by the District Court without opinion, appear in R., pp. 63-68. The Circuit Court's opinion appears in R., pp. 72-76. The facts, which were stipulated, appear in R., pp. 36-47.

The matters dealing with this Court's jurisdiction, the federal statute involved, the questions presented, the statement of the case and the reasons for granting the writ are all set forth in the petition *supra*, to which reference is respectfully made.

POINT I.

The rights of petitioner are governed solely by controlling federal law and not by local law.

The Circuit Court, in its opinion, held that petitioner's rights must be determined under New York law and cited Collier on Bankruptcy [14th Ed.] Section 70.62. In so doing, however, it overlooked Section 70.70 of Collier's, entitled "State Law, or Federal Law Where Applicable, Determines Existence and Effect of Liens or Other Claims", which states at page 1348:

> "Of course, in the unusual case where a federal statute is invoked as the basis for a lien or claim, that statute as interpreted by the federal courts will control."

Erie Railroad Co. v. *Tompkins,* 304 U. S. 817, is not to the contrary. There, the late Mr. Justice Brandeis points out at page 822:

> "Except in matters governed by the Federal Constitution *or by Acts of Congress,* the law to be applied in any case is the law of the states." (Emphasis supplied.)

In *Henningsen* v. *United States Fidelity & Guaranty Co.,* 208 U. S. 404, which involved as does here the priority rights of a surety under a Miller Act bond (then the Heard Act), Mr. Justice Brewer, in the very first sentence of his opinion points out that the grounds of suit and relief were based on statutes of the United States.

In *Prudence Realization Corp.* v. *Geist,* 316 U. S. 89, the late Mr. Chief Justice Stone said at page 95:

> "Nothing decided in *Erie* v. *Tompkins supra* requires a court of bankruptcy to apply such a local rule governing the liquidation of insolvent assets. * * * In the interpretation and application of federal statutes, federal, not local law applies."

As was pointed out by petitioner in its petition for rehearing in the Circuit Court, R., p. 82, Collier's 1946 Cumulative Supplement at Page 79, Vol. 4, criticizes the 1943 decision of the Sixth Circuit in the *Matter of Zaepfel & Russell Inc.*, affirmed *sub nom., Farmers State Bank* v. *Jones,* 135 Fed. (2d) 215, where the court, on a state contract, applied the federal rule of priority and sustained the claims of the surety company and overruled the claims of two banks to priority over the proceeds of a building contract held in the hands of a trustee in bankruptcy. Collier's reasoning is that a prior decision of the Sixth Circuit in *Farmers Bank* v. *Hayes,* 58 Fed. (2d) 34, which rejected the Kentucky rule of priority and applied the federal rule (on a bond given in connection with a state contract), while it may have been good law in 1932 when the *Farmers Bank* case was decided, was not good law today in the light of *Erie R. Co.* v. *Tompkins supra.* Collier's ends its discussion, however, with the following significant statement:

> "We conclude, therefore, that the case at bar was correctly decided, only if the surety was a federal surety."

It will be seen that while Collier's criticizes the application of the federal rule of priority to a payment bond given in connection with a state contract, it ap-

proves the application of the federal rule to a federal surety. Here, the petitioner was a federal surety. Furthermore, in discussing the *Prairie State National Bank* v. *U. S.*, 164 U. S. 227 case, and the *Henningsen* case *supra* (which laid down the federal rule of priority which has been followed through all the years), and in referring to the statement in the *Henningsen* case that the surety's rights and obligations involve a federal matter, Collier's states:

> "This is not unreasonable, since it would be desirable to have a uniform rule on the rights and liabilities of sureties to the United States."

POINT II.

New York law is the same as the federal law insofar as the surety's equitable right of priority on this type of bond is concerned.

The Circuit Court, by its decision, apparently conceded the existence of the surety's equitable right of priority under federal law, but by applying New York State decisions having nothing to do with the rights of sureties under Miller Act bonds or with the rights of sureties under similar bonds given in connection with state construction contracts, held that the surety's right in the instant case was deferred to the liens of the judgment creditor and the trustee in bankruptcy.

In so doing, however, the Circuit Court completely disregarded the fact that the New York Courts, whenever called upon to decide the rights of sureties under a similar bond in connection with a state contract, have applied the federal rule of priority.

In *Scarsdale National Bank & Trust Co.* v. *U. S. Fidelity & Guaranty Co.*, 264 N. Y. 159, the New York Court of Appeals had before it the conflicting claims of a surety on the performance bond of a contractor and a bank which had advanced moneys to the contractor on the strength of an assignment of the moneys due the contractor from the state, the contractor having defaulted and the surety having completed the contract at a loss. The Court of Appeals, citing *Prairie State Bank* v. *United States*, 164 U. S. 227; *Henningsen* v. *U. S. Fidelity & Guaranty Company*, 208 U. S. 404, and others, held that the equity in favor of the surety arose at the time of the giving of its bond and that the right became available when the surety completed the work at a loss and that since the equitable lien arose at the time of the execution of the bond, it was superior to the assignment.

Century Cement Mfg. Co., Inc. v. *Fiore*, 264 App. Div. 475, involved the conflicting claims of an assignee of the contractor and the surety on a payment bond to the balance in the hands of the state. The New York Appellate Division citing *Martin* v. *National Surety Company*, 300 U. S. 588, and *Scarsdale National Bank & Trust Co.* v. *U. S. Fidelity & Guaranty Co., supra*, held the surety entitled to that balance, and stated at page 480:

> "The fact that the 'completion' bond was involved in the *Scarsdale* case and the 'material and labor' bond in the instant case is immaterial * * *
>
> "The rule that the surety company's equitable lien arose at the time of the execution of the bond and is accordingly superior to a subsequent

assignment is established by ample authority. The principle is enunciated in *Prairie State Bank* v. *United States* (164 U. S. 227). It is supported by a line of Federal court decisions, including *Maryland Casualty Co.* v. *Board of Water Comrs.* (66 F. (2d) 730); *Lacy* v. *Maryland Casualty Co.* (32 id. 48); *Henningsen* v. *U. S. Fidelity & Guaranty Co.* (208 U. S. 404); *Hardaway* v. *National Surety Co.* (211 id. 552), all cited as authority in the *Scarsdale* case."

In *Municipal Housing Authority* v. *Hatfield Electric Corp.*, 264 App. Div. 99, the New York Appellate Division, Fourth Department, followed the same rule in a case again involving the rights of a surety under a payment bond and said at page 103:

"We are of the opinion that the surety became subrogated to the moneys in the hands of the housing authority. That right arose at the time the surety executed the bond. (*Scarsdale National Bank & Trust Co.* v. *U. S. F. & G. Co.*, 264 N. Y. 159). The contractor had no interest in the fund which he could pass to the bank at the time the assignment was executed and delivered. The judgment appealed from should be reversed on the law and facts and judgment entered in favor of the appellant Aetna Casualty & Surety Company."

The latest New York Court of Appeals case on this subject, decided in July 1947, is *U. S. Fidelity & Guaranty Company* v. *Triborough Bridge Authority*, 297 N. Y. 31, in which the Court reaffirmed its decision in *Scarsdale National Bank & Trust Co.* v. *U. S. F. & G. Co., supra,* and cited with approval

Prairie State Bank v. *United States, supra,* and held that a surety which had made payment to labor and material creditors on a bond given in connection with a state contract was entitled, by virtue of its equitable lien to the fund in the hands of the Triborough Bridge Authority as against the United States Government, which had filed a tax lien for taxes owed by the contractor.

POINT III.

The decision below is in conflict with decisions of the Supreme Court and of other Circuit Courts of Appeals.

Prairie State National Bank v. *U. S.,* 164 U. S. 227, first established the law that where a surety completes a defaulted contract of its principal, it becomes entitled to the moneys in the hands of the Government applicable to the completion of that contract, ahead of any other creditor. *Henningsen* v. *U. S. Fidelity & Guaranty Co.,* 208 U. S. 404, established the law that where the contractor has himself completed the contract, but has failed to pay for labor and material, the surety paying the laborers and materialmen under its payment bond is likewise subrogated to the original and continuing equitable priority in the fund, of those laborers and materialmen.

In *Belknap Hardware & Mfg. Co.* v. *Ohio River Contract Co.,* 271 Fed. 144 (C. C. A. 6) (1921), the Circuit Court, in discussing the *Henningsen* case, *supra,* said at page 148:

> "* * * we think the necessary effect of the decision is to hold that the laborers and material-

> men, in spite of or in addition to the giving of the bond, had an original and continuing equitable priority in the fund and that it was this right to which the surety was subrogated."

and at page 151:

> "We therefore conclude that the labor and material claimants are entitled to priority in the distribution of the funds in the receiver's hands as against other creditors."

In *United States Fidelity & Guaranty Co.* v. *Sweeney*, 80 F. (2d) 235 (1935), the Eighth Circuit held that the surety was bound by contract to pay the claims for labor and material, and upon paying those claims it was entitled to be subrogated to the superior equities of the laborers and materialmen, and that when the surety made payment, its rights related back to the date of its bond.

In *Farmers Bank* v. *Hayes*, 58 F. (2d) 34, the Sixth Circuit rejected the Kentucky rule of priority and applied the federal rule on a bond given in connection with a state contract and held that the right of the surety to the fund there in question was settled by a long line of federal and state cases. The court there stated that whether in that particular case the surety's rights arose out of subrogation to the rights of the board of trust (under whose jurisdiction the work was performed) or the equitable liens of the laborers and materialmen, the result was the same and that in either case, the equitable rights of the surety became fixed as of the date of the bond and were "* * * superior to those of any holder of an after acquired lien".

In *Cox* v. *New England Equitable Insurance Company, Inc.*, 247 Fed. 955, the Eighth Circuit had before it a case on all fours with the instant case, and at that time the provisions arming the trustee with the right of a creditor holding a lien now contained in Section 70c of the Bankruptcy Act, was part of the then Section 47a(2). There the contractor on a government contract had completed the work but had failed to pay labor and material claims. The government made the final payment to the contractor, who deposited it in his bank and the bank credited the same upon the contractor's indebtedness to it. The contractor was subsequently adjudicated a bankrupt and his trustee recovered the money from the bank as an unlawful preference. There, as in the instant case, the surety claimed the fund from the trustee and the Circuit Court held that since the surety had a lien upon the fund while it was in the hands of the government, that such lien was not lost since the fund had been fully and accurately traced into the hands of the trustee. In the instant case, the existence, identity and tracing of the fund is conceded.

In *Moran* v. *Guardian Casualty Co.*, 76 F. (2d) 437, there was also involved a contest between a receiver and a surety on the bond of a contractor with respect to a fund paid over by the government to the receiver and which represented the balance due the contractor for work done under a government contract, the surety having made payment of labor and material claims under its bond. The Circuit Court affirmed the decision of the lower court and held that the surety had a superior lien upon the fund in the hands of the trustee in bankruptcy.

In *Philadelphia National Bank* v. *McKinlay, Trustee,* 72 F. (2d) 89, cert. den., 293 U. S. 583, the Court of Appeals for the District of Columbia, in a case which likewise involved a fund in the hands of a trustee in bankruptcy, held that in no case could the fund be considered due the bankrupt, and hence to its trustee, for the trustee had no greater interest than the bankrupt at the date of bankruptcy, and that at the time of the bankruptcy, the only right which the bankrupt could assert to any of the fund in question was contingent upon there being a surplus after the reimbursement of its surety, whose obligation was not only to do the work, but to pay for labor and materials.

In re L. H. Duncan & Sons, 127 F. (2d) 640, involved a controversy between the trustee in bankruptcy and the surety on the contractor's bond in connection with a Pennsylvania works contract. There, the Third Circuit held that the surety's right of subrogation to laborers and materialmen in the fund was paramount to the right of the trustee in bankruptcy.

In the *Matter of Zaepfel & Russell, Inc.,* affirmed *sub nom., Farmers State Bank* v. *Jones,* 135 Fed. (2d) 215, the Sixth Circuit, on a state contract, affirmed the decision of the District Court, 49 Fed. Supp. 709, which had in turn confirmed the order of the Referee in Bankruptcy which sustained the claims of ~~two~~ the ~~banks~~ parties to priority over the proceeds of a building contract held in the hands of the trustee in bankruptcy. The District Court stated clearly that the question of priority depended upon whether the court followed the rule adopted by the federal courts or

the rule announced by the Court of Appeals of Kentucky and then went on to follow the federal rule.

The decision of the Circuit Court in the instant case to the effect that the trustee's lien was superior to that of the surety is clearly in conflict with the cases above cited. Its decision that the judgment creditor's lien is superior to that of the surety is also in conflict with those cases above cited which hold that the contractor had no right to the fund and that the same did not belong to him except to the extent that any surplus might remain after reimbursement of his surety. Obviously, the judgment creditor could not acquire a lien on that which was not the property of the bankrupt. Yet, the Circuit Court in this case, by the application of New York State decisions having nothing to do with the rights of a surety under a Miller Act bond or the rights of sureties on bonds given in connection with state contracts, has arrived at the unusual conclusion that the judgment creditor of the bankrupt, by the service of its Third Party Order, acquired a lien on a fund which, by the weight of authority, never belonged to the bankrupt.

The suggestions in the Circuit Court's opinion that it was questionable whether the surety's lien extended to any other amounts other than the reserved percentage is likewise in conflict with the decisions of the Supreme Court and of other Circuit Courts of Appeals and will cause considerable havoc in the application of funds arising out of government contracts. The overwhelming weight of authority of all of the cases hereinbefore cited does not limit the surety's rights to the retained percentages only, but refers instead to the "fund" or "funds". The effect of this entire body of case law would be destroyed if the surety's lien were held to apply only to the insignificant por-

tion of the contract represented by the reserved or retained percentages. The doctrine underlying all the decisions on this subject is founded upon the principle that since a labor or material creditor cannot under the law file a lien against government property for the protection of his rights, that the moneys applicable to the performance of the government contract shall be available for his benefit and for the benefit of the surety which is subrogated to his rights.

Not only does the overwhelming weight of the federal decisions not so limit the rights of the surety, but none of the New York decisions in connection with payment bonds on state contracts so limit them. In *U. S. F. & G. Co.* v. *Triborough Bridge Authority,* 297 N. Y. 31 (1947), the controversy concerned the "final payment due under the contract" and not merely the retained or reserved percentages, and it was to that final payment that the New York Court of Appeals held the surety subrogated ahead of the rights of the government which had filed a tax lien for taxes owed by the contractor.

In *Lacy* v. *Maryland Casualty Co.,* 32 Fed. (2d) 48, the Circuit Court, citing cases including *Prairie State National Bank* v. *United States* and *Henningsen* v. *United States Fidelity & Guaranty Co., supra,* clearly met the proposition here discussed and said:

> "The question arises whether this superior equity of the surety extends to the current estimates payable under the contract or merely to the retained percentages. We think that it extends to both."

The extent to which the Circuit Court's decision in the instant case is in conflict at this point with the decisions of other Circuit Courts is perhaps best illustrated by the decision of the Eighth Circuit in *London & Lancashire Indemnity Company of America* v. *Endres,* 290 Fed. 98. In that case the bankruptcy court allowed the surety's claim, but refused to give it preference in payment out of a fund which came into the hands of the contractor's trustee in bankruptcy and which represented extra compensation, beyond the contract price, voted to the bankrupt contractor by an Act of Congress. The trustee there contended that inasmuch as the fund in his hands was not part of the original contract price, that the surety acquired no lien thereon. The Circuit Court stated that it was argued that the appropriation was a mere gratuity and having been given without legal obligation to do so, no rights could be asserted against it. The Court held however, that it was not a mere gratuity, but was further compensation for the construction work in question and in that sense should be regarded as an increase to the consideration named in the contract. The Court, citing *Henningsen* v. *U. S. F. & G. Co.* and *Prairie State Bank* v. *United States, supra,* held in favor of the surety, reversed the order below and directed preferential payment to the surety out of the appropriation to the extent of its loss.

In the *Endres* case, there was not involved any question of either retained percentage or final payment under the contract, but instead a payment voted by Congress dehors the contract. Yet, the Circuit Court held the surety entitled, to the extent of its loss, to a lien on the fund voted by Congress.

In the instant case, the Circuit Court stated that it did not feel it necessary to determine the question

of whether the surety's right of subrogation was limited only to the reserved or retained percentages, in view of its finding that the liens of the trustee in bankruptcy and of the judgment creditor were superior to those of the surety. However, the question is of such vast importance to all sureties on government contracts, and the Circuit Court's decision so far in conflict with the weight of authority, that that issue should also be passed upon by this Court in order to forestall the serious conflicts and impediments which must necessarily arise in the future by this erroneous dictum of the Circuit Court.

CONCLUSION.

In view of the foregoing, it is respectfully submitted that this Court should grant the writ of certiorari prayed for in the petition to which this brief is annexed.

Respectfully submitted,

SAMUEL GOTTESMAN,
Attorney for Petitioner.

New York City, October, 1948.

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Respondents.

REPLY BRIEF FOR PETITIONER ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

SAMUEL GOTTESMAN,
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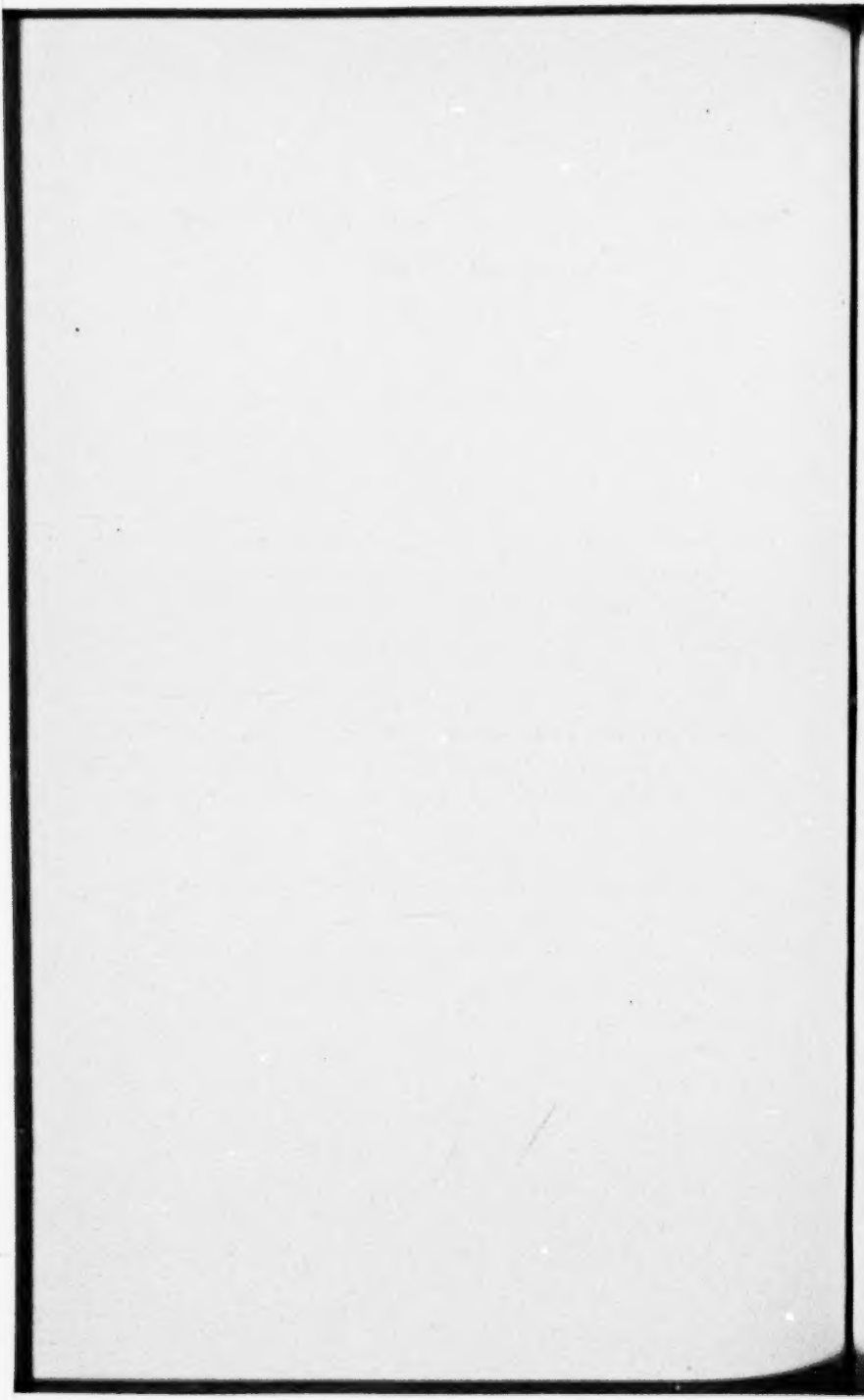

IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 356.

THE CENTURY INDEMNITY COMPANY,

Petitioner,

—against—

RICHARD L. ROSENBAUM, Trustee in Bankruptcy for Ultimite Corporation, Bankrupt, and GRAYS FERRY BRICK COMPANY,

Respondents.

REPLY BRIEF FOR PETITIONER ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

The brief of the trustee completely begs the main issue involved in this case, namely, whether the rights of a surety on a bond given pursuant to a federal statute are to be governed by federal law or by state law. It points to no case where state law was applied to a Miller Act bond. It overlooks completely the fact that labor and material creditors on a government job and the surety, as subrogee of those creditors, have by the overwhelming weight of authority, been awarded special rights in and to the moneys arising out of a government contract because of the fact that such labor and material creditors cannot file liens against government property to protect their interests.

In the instant case neither the trustee in bankruptcy nor the judgment creditor is in the position of a bona fide purchaser for value without notice and the fund in question was created and in existence, capable of identification, before any lien was acquired by either of them (Referee's opinion, R., p. 66). The only result of the Circuit Court's decision is to make available to general creditors of the bankrupt a fund representing the final payment on a government contract when those creditors had nothing to do with the creation of that fund, to the detriment of labor and material creditors (and the subrogated surety) who because the contract was for the construction of a government building, were barred by law from filing a lien for the protection of their rights. It is this factor which underlies the entire body of federal case law on the rights of labor and material creditors and the subrogated surety on the payment bond.

In Point II of his brief, the trustee attempts to make the point that the decision of the Court below is not in conflict with the decisions of the Supreme Court or of other Circuit Courts or of the New York Courts. Yet, every case cited in petitioner's main brief under Point II and III, negatives this attempt.

The trustee, on page 11 of his brief, states that those cases cited by petitioner where the contracts were completed but in which unpaid laborers and materialmen were held to have an equitable lien superior to the claims of general creditors or assignees, to which lien the surety was subrogated upon payment, were only those in which the moneys were still in the possession of the government. This is not so.

In the following cases, all cited in petitioner's main brief, the moneys were no longer in the hands of the government, but, as here, were in the hands of the contractor's trustee in bankruptcy, and the surety was held entitled thereto ahead of the claims of the trustee, general creditors or assignees:

Cox v. *New England Equitable Insurance Company,* 247 Fed. 955;

Moran v. *Guardian Casualty Co.,* 76 Fed. (2d) 438. (The moneys here were in the hands of a receiver.);

Philadelphia National Bank v. *McKinlay,* 72 Fed. (2d) 89, cert. den. 293 U. S. 583;

In re: *L. H. Duncan & Sons,* 127 Fed. (2d) 640;

Matter of Zaepfel & Russell Inc., 49 Fed. Supp. 709, affirmed sub. nom. *Farmers State Bank* v. *Jones,* 135 Fed. (2d) 215;

London & Lancashire Indemnity Company of America v. *Endres,* 290 Fed. 98.

In the last cited case, the fund to which the Eighth Circuit held the surety entitled ahead of the trustee and all other creditors did not even involve the final payment under the contract as does the instant case. It involved, instead, extra compensation beyond the contract price voted to the bankrupt contractor by an Act of Congress.

The trustee's statement that the Miller Act and its predecessor statute does not create a lien in favor of unpaid laborers and materialmen is contrary to the overwhelming weight of authority, as evidenced by

the following decisions of the Supreme Court and other Circuit Courts cited in petitioner's main brief:

Henningsen v. *United States Fidelity & Guaranty Co.*, 208 U. S. 404;

Belknap Hardware & Mfg. Co. v. *Ohio River Contract Co.*, 271 Fed. 144;

U. S. Fidelity & Guaranty Company v. *Sweeney*, 80 Fed. (2d) 235;

Farmers Bank v. *Hayes*, 58 Fed. (2d) 34, cert. den. 287 U. S. 602;

Cox v. *New England Equitable Insurance Company*, 247 Fed. 955;

which hold that where the contractor has himself completed the contract but failed to pay for labor and material, that the laborers and materialmen, in spite of, or in addition to the giving of the bond, had an original and continuing equitable priority in the fund; that the surety was subrogated to that right and that when the surety made payment, its rights related back to the date of its bond.

Clearly the decision of the Court below in the instant case is in direct conflict with those above referred to and others not cited.

The trustee's brief also completely begs the proposition that the bankrupt had no right to the fund except to the extent that a surplus might remain after payment of labor and material creditors and to the subrogated surety, and that therefore neither the trustee nor the judgment creditor could acquire a lien on that which was not the property of the bankrupt. (*Philadelphia National Bank* v. *McKinlay* and *In re*: *L. H. Duncan & Sons*, both *supra*.)

The trustee's brief also begs the proposition that even if New York law is applicable to the rights of a federal surety (which petitioner disputes), that the New York cases cited in petitioner's main brief have consistently followed the federal rule in connection with payment bonds on New York state contracts, and that other Circuit Courts have likewise applied the federal rule to contracts of other states.

The statement by the trustee in Point III of his brief that the decisions relied upon by petitioner did not pass upon the question presented in the instant case is clearly negatived by all of the decisions cited in petitioner's main brief and particularly by those where the moneys were already in the hands of the contractor's trustee in bankruptcy and the surety was permitted to recover them.

Equally unfounded is the statement of the trustee that the decision of the Circuit Court below is of limited application and is not of general importance. The cases cited in petitioner's main brief and the many others on the same subject which were not cited, make it clear that the instant decision which is in conflict with all of those cases, disrupts completely the entire field of case law on this subject and leaves in a state of chaos and confusion the rights of labor and material creditors and their subrogated sureties on all government contracts now in existence and which may hereafter be let.

Nor is there any basis for the contention of the trustee that "the question presented has been rarely raised although the Miller Act and its predecessor Acts have been in existence over a great number of years". The many decisions on this subject negative that statement. What is important, however, is that

it has never before been resolved in the manner adopted by the Circuit Court in the instant case and for that very reason should be reviewed by this Court.

CONCLUSION.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

SAMUEL GOTTESMAN,
Attorney for Petitioner.

New York City, November, 1948.

IN THE

Supreme Court of the United States

October Term, 1948.

No. 356.

THE CENTURY INDEMNITY COMPANY,
Petitioner,

AGAINST

RICHARD L. ROSENBAUM, Trustee in Bankruptcy for ULTIMITE CORPORATION, Bankrupt, and GRAYS FERRY BRICK COMPANY,
Respondents.

Brief on Behalf of Respondent Rosenbaum, Trustee in Bankruptcy, in Opposition to Petition for Writ of Certiorari.

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INDEX.

CASES CITED.

STATUTES AND AUTHORITIES CITED.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

THE CENTURY INDEMNITY COMPANY, *Petitioner,* AGAINST RICHARD L. ROSENBAUM, Trustee in Bankruptcy for ULTIMITE CORPORATION, Bankrupt, and GRAYS FERRY BRICK COMPANY, *Respondents.*	No. 356.

Brief on Behalf of Respondent Rosenbaum, Trustee in Bankruptcy, in Opposition to Petition for Writ of Certiorari.

Question Presented.

Is the equitable claim of the petitioner-surety company entitled to priority over a judgment-creditor and a Trustee in Bankruptcy armed with the rights of a judgment-creditor?

Summary of Argument.

There is no question of federal law involved and under applicable decisions the equitable claim of the surety petitioner is subordinate to the rights of the judgment-creditor and the Trustee in Bankruptcy. No special or important reasons exist for certiorari.

The Facts.

The facts were stipulated and are as follows:

On December 20, 1941, the bankrupt entered into a contract with the Government for certain construction work at Scituate, Mass. (fol. 112). On December 30, 1941, the Century Indemnity Company, hereinafter referred to as Surety, executed and delivered its Payment Bond guaranteeing payment to all persons supplying labor or material in the prosecution of the work provided for in that contract, as required by law (fol. 113). The bankrupt completed the contract but failed to pay in full for all labor and materials supplied to it in the prosecution of the work, with the result that the Surety, pursuant to its obligation on its payment bond, was obliged to and did pay to persons supplying labor and materials to the bankrupt under that contract, the total sum of $3,762.22 (fols. 115-117). All persons in the category aforementioned who made claim under its bonds were paid by the Surety and at the time of making such payments, it obtained assignments from those persons, of their rights against the bankrupt (fol. 117).

After making the contract with the Government, aforesaid, the bankrupt assigned to the Jamaica National Bank of New York, hereinafter referred to as the Bank, the monies due from the Government under said contract, and on July 6, 1942, the Bank received from the Government the sum of $4,152.50, which represented the balance due from the Government thereunder (fols. 118-119).

At the time of the receipt of this money by the Bank, the bankrupt was no longer indebted to it under the assignment, and the Bank had no interest in the fund, except for some $33.27 representing an overdraft or other charge due from the bankrupt (25).

Upon receiving said sum of $4,152.50 from the Government, the Bank deducted the overdraft or other charge

against the bankrupt in the sum of $33.27, and deposited the balance of $4,119.23 to the account of the bankrupt (fol. 121).

On July 11, 1942, Grays Ferry Brick Company, hereinafter referred to as Grays, recovered judgment against the bankrupt in the United States District Court for the Eastern District of New York, in the sum of $5,497.33; filed a transcript of the judgment with the Clerk of the New York County on July 13, 1942, and on July 14, 1942 served a Third Party Order on the Bank (fol. 122), under Section 799(a) of the New York Civil Practice Act.

Grays' judgment was not for labor or material supplied to the bankrupt in the prosecution of the work called for by its contract with the Government, but for concrete blocks sold to the bankrupt (fol. 123).

On July 14, 1942 the bankrupt made an assignment for the benefit of creditors which was recorded in the County of New York on July 17, 1942 (fol. 109).

An involuntary petition in bankruptcy was filed against the bankrupt on July 21, 1942, on which date the bankrupt was insolvent within the meaning of the Bankruptcy Act (fol. 110).

The bankrupt was duly adjudicated on August 6, 1942. A Receiver was appointed on July 21, 1942, and qualified on July 22, 1942. After adjudication, and on October 15, 1942, the Receiver was elected Trustee. Thereafter the Trustee resigned and the present Trustee was appointed Substituted Trustee, and duly qualified (fol. 111).

After the service by Grays on the Bank of the Third Party Order aforesaid, and the filing of the involuntary petition against the bankrupt, the Receiver instituted a proceeding in the District Court to compel the Bank to pay over to him the net sum in question (fol. 32). On August 5, 1942, an order was made directing the Bank to pay over the said sum subject to any lien which Grays might have (fol. 126). The Surety was not a party to the

proceedings which resulted in the order, and had no knowledge thereof until after the making of the order (fols. 126-127).

On August 6, 1942, the Bank paid to the Receiver the said sum, which was thereafter deposited into the Receivership Account, and now forms part of the balance in the estate account (fols. 128-129).

In addition to those persons who supplied labor or materials to the bankrupt in the prosecution of the Government contract in question, and to whom the Surety made payment under its Payment Bond, five other creditors filed proofs of claim with the Referee for labor or materials supplied to the bankrupt under the same contract. The claims of these five creditors aggregate the total sum of $258.14 (fol. 129).

On July 21, 1942 (the date of the filing of the involuntary petition) the liabilities of the bankrupt, in accordance with the proofs of claim filed with the Referee, exceeded its assets by approximately $100,000, and the bankrupt was insolvent within the meaning of the Bankruptcy Act, of which condition the Surety and Grays had reasonable cause to believe (fol. 134). The Trustee has insufficient money or property to pay in full all liabilities due all classes of creditors of the bankrupt (fol. 135).

The answer interposed on behalf of the Trustee, other than denials of fact since obviated by the stipulation of facts affirmatively alleged that the rights of the Century Indemnity Company were subordinated to those of the Trustee in Bankruptcy (fol. 99); and deeming the transfer as having been made immediately before bankruptcy, said transfer was voidable as a preference under Section 60 of the Bankruptcy Act (fol. 100).

POINT I.

There Is No Question of Federal Law Involved.

The petitioner contends its rights are governed by the Miller Act, 40 U. S. C. A. Section 270, and that by reason thereof federal law and not state law must apply.

Laborers and materialmen do not have enforceable rights against the United States for their compensation and cannot acquire a lien on public buildings. As a substitute for that protection, the various statutes of which the Miller Act was the last, were enacted so as to require a surey to guarantee their payment.

> *Equitable Surety Co.* v. *United States,* 243 U. S. 488, 34 S. Ct. 803, 58 L. Ed. 1394;
> *United States* v. *Ansonia Brass Co.,* 218 U. S. 452, 31 S. Ct. 49, 54 L. Ed. 1107.

It has been specifically held that the Miller Act, and its predecessor statutes, does not create a lien in favor of unpaid laborers and materialmen.

> *In Re Flotation Systems Inc.* (D. C. Cal.), 65 F. Supp. 688, 701;
> *Sears* v. *Mahoney* (C. C. La.), 66 Fed. 860.

The United States is not a party in interest and the action is not on the bond executed by the petitioner. The basis of the rules as to the existence of equitable rights is found in equitable principles and not in any federal statute. (*Prairie State National Bank* v. *United States,* 164 U. S. 277, 17 S. Ct. 142, 51 L. Ed. 412.) The Miller Act does not create, limit, or expand the equitable rights of anyone.

The matter presented does not involve the interpretation and application of a Federal Statute such as present

in *National Bank* v. *Downie,* 218 U. S. 345, 31 S. Ct. 89, 54 L. Ed. 1065; and in *United States* v. *Reese* (C. C. A. 7) 131 F. (2) 466. Even as to rights created by federal statute, it has been held that a State is free to place limitations upon the time in which the remedy granted can be asserted in the State, and upon the assignability of the cause of action, without impairing the rights created by Congressional statutes.

Campbell v. *Haverhill,* 155 U. S. 610, 15 S. Ct. 217, 39 L. Ed. 280;
Chattanooga Foundery & Pipe Works v. *Atlanta,* 203 U. S. 390, 27 S. Ct. 65;
Momand v. *Twentieth Century Fox Film Corp.* (D. C. Okl.) 37 F. Supp. 649.

The petitioner, armed with an equitable lien, invoked the jurisdiction of the Bankruptcy Court to enforce its rights as against the Trustee. The Trustee is vested not only with the title of the bankrupt but clothed with the righ of an execution creditor with a levy on the property which passes into the Trustee's custody. *Myers* v. *Matley* 318 U. S. 622, 63 S. Ct. 780, 87 L. Ed. 1043; Bankruptcy Act Section 70c, Section 110 United States Code, Title 11, Chapter 7.

The extent of the Trustee's rights, remedies and powers as a lien creditor are measured by the substantive law of the jurisdiction governing the property in question.

Sapero v. *Neiswender* (C. C. A. 4), 24 F. (2) 403;
Commercial Credit Co. Inc. v. *Davidson* (C. C. A. 5), 112 F. (2) 54;
Matter of Allied Products Co. (C. C. A. 6), 134 F. (2) 725.

Any doubts on the subject were dispelled by the principles expressed by this Court in *Erie Railroad Co.* v.

Tompkins, 304 U. S. 64, 58 S. Ct. 817, 82 L. Ed. 1188, and the rulings in *Prudence Realization Corporation* v. *Geist,* 316 U. S. 89, 62 S. Ct. 982, 86 L. Ed. 1293, and *American Surety Company of New York* v. *Sampsell,* 327 U. S. 269, 66 S. Ct. 571, 90 L. Ed. 663, that the application of federal law governing the distribution of a bankrupt's estate is made with appropriate regard for rights acquired under rules of state law.

The petitioner does not contend that the Court below incorrectly stated the New York law that an equitable lien is deferred to legal liens obtained upon property by judgment-creditors and Trustees in Bankruptcy.

In none of the cases relied upon by the petitioner was there a third party order the effect of which is fixed in Section 799a of the New York Civil Practice Act as follows:

> "Every transfer by the judgment-debtor by assignment or otherwise, of any property held by, or debt due from a third party upon whom there shall have previously been served an order or subpoena containing any stay or injunction as provided in this article, shall be subject to such rights and remedies as the judgment-creditor would have had if such transfer had not been made; except that the foregoing provisions of this section shall not apply to (a) a transfer of a debt evidenced by a negotiable instrument which has been transferred to a transferee in good faith and for value, or (b) transfer of property which has been delivered, or for which a negotiable warehouse receipt, negotiable bill of landing or other negotiable document of title has been delivered, to a transferee in good faith and for value. (Added L. 1938, ch. 605, in effect Sept. 1.)"

It has also been repeatedly held that equitable liens and subrogation will not be enforced at the expense of a legal right.

German Savings & Loan Society v. *Tull* (C. C. A. 9), 136 F. 1, 6;
Gray v. *Jacobsen,* 56 App. D. C. 353, 13 F. (2) 959;
American Surety Co. v. *Citizens Bank* (C. C. A. 8), 294 Fed. 609, 616;
People v. *Peoples Bros.* (D. C. Pa.), 254 Fed. 489, 492;
Bell v. *Greenwood,* 229 App. Div. 550;
Laski v. *State,* 217 App. Div. 426;
Federal Land Bank v. *Smith,* 129 Me. 233, 151 A. 420;
Land v. *Cutler,* 155 Mass. 451, 29 N. E. 1085.

POINT II.

The decision of the Court below is not in conflict with the decisions of the Supreme Court, or of other Circuit Courts, or of the New York Courts.

All of the cases cited by the petitioner in Point I and Point II of its brief fall into two categories.

The first is where the contractor defaulted and the contract was completed by the surety. Here it was uniformly held that the surety was subrogated to the rights of the government, and was vested with a right of ownership to all unpaid monies until complete reimbursement.

This line of cases is based upon *Prairie State National Bank* v. *United States,* 164 U. S. 277, 17 S. Ct. 142, 51 L. Ed. 412, which established the law that where a surety completes a defaulted contract of its principal, it becomes entitled to the monies in the hands of the government ap-

plicable to the completion of that contract ahead of any general creditor.

In *Farmers Bank* v. *Hayes* (C. C. A. 6), 58 F. (2) 34, 37, the litigation was between the surety and a bank. The contractor, at the time of the procurement of the bond, assigned to the surety all deferred payments, retained percentages, and monies due at the time of any breach by the contractor. Thereafter the contractor assigned all earnings under the contract to the bank as collateral for a loan. After default by the contractor, the surety completed the contract. The surety prevailed.

In *London & Lancashire Indemnity Co.* v. *Endies* (C. C. A. 8), 290 Fed. 98, the surety performed the contract and sued to enjoin the payment of the reserve to the contractor, who, pending the suit, went into bankruptcy. The surety prevailed on the authority of the *Prairie Bank* case (*supra*).

In *Lacy* v. *Maryland* (C. C. A. 4), 32 F. (2) 48, the litigation involved the surety and a bank. The contractor, who had assigned monies due under the contract first to the surety and then to a bank, defaulted in the performance of the contract which was completed by the surety. The surety prevailed. The basis of the decision therein is summarized by the Court in *Matter of Allied Products Co.* (C. C. A. 6), 134 F. (2) 725, as not resting on the equitable principle of subrogation, but on the ground that the assignment to the surety had priority over the subsequent assignments.

In *Philadelphia National Bank* v. *McKinley* (C. C. A. Dist. Col.), 72 F. (2) 89, cert. den. 293 U. S. 583, unpaid laborers filed a bill in the District Supreme Court for an order directing the Secretary of Treasury to pay a balance due under a government construction contract to a receiver to be appointed by the Court and for disposition of the fund to laborers and materialmen. The bankrupt contractor had defaulted and "the surety then under-

took the performance of the balance of the contract" (p. 90), under a direct contract with the United States whereby it was to be paid. The Trustee moved to dismiss the bill on the ground that the contractor being adjudged bankrupt the District Supreme Court had no jurisdiction to administer the fund for the benefit of creditors.

The Court held surety subrogated to rights of the United States and stated (p. 91):

> "* * * the bankrupt having abandoned the work and defaulted in the performance of the contract, and its surety having taken over the work, the latter, rather than the former, would be clearly entitled to the fund to the extent necessary to reimburse it for moneys expended in carrying it out, and the surety would in such case be bound to those doing work and furnishing materials. * * * At the time of bankruptcy, the only right which the bankrupt could assert to any of the fund in question was contingent upon their being a surplus after the reimbursement of its surety for the work done by it, and the obligation of the surety was not only to do the work, but to pay for the labor and materials, and admittedly the fund is insufficient for this."

Further, the Court, after noting the funds in the hands of the United States was insufficient to pay all claims, and holding that the Trustee could have no claim to it, added (p. 92):

> "It is not property which prior to the filing of the petition, the bankrupt could have transferred, or which could have been levied upon and sold under judicial process against it."

In *Scarsdale National Bank & Trust Co.* v. *U. S. Fidelity & Guaranty Co.*, 264 N. Y. 159, the litigation was between the surety and a bank which had taken an assignment of monies due the contractor from the state. The surety completed the contract after the contractor's default. The Court held the surety subrogated to the state's right "to retain earned moneys and apply them on the cost of any completed work".

In the instant case, the bankrupt completed the contract and thus the rule of subrogation to the rights of the government is inapplicable. There can be no subrogation when there is nothing to which rights may attach. *United States* v. *Munsey Trust Co.*, 332 U. S. 234, 67 S. Ct. 1599; *Sexauer & Lemke* v. *Burke Sons Co.*, 228 N. Y. 341, and it is respectfully submitted that the above cases relied upon by petitioner are inapplicable herein.

The second class of cases cited by the petitioner is based upon facts indicating that the contract was completed and it was held that unpaid laborers and materialmen had an equitable lien on the funds reserved or the percentages retained under the contract or upon unpaid sums still in the possession of the government, superior to the claims of general creditors or assignees, to which lien the surety was subrogated upon payment.

This class is illustrated by *Hennigson* v. *United States Fidelity & Guaranty Co.*, 208 U. S. 204, 28 S. Ct. 389, 52 L. Ed. 987, where the litigation was between the surety and general creditor and the monies involved constituted the funds retained by the government.

In *Belknap Hardware & Mfg. Co.* v. *Ohio River Contracting Co.* (C. C. A. 6), 271 Fed. 144, the litigation was between labor and material suppliers and money loan creditors over the "retained percentage" under a contract which an equity receiver completed after the contractor's default.

In *United States Fidelity & Guaranty Co.* v. *Sweeney* (C. C. A. 8), 80 F. (2) 235, 238, it was held that the surety's rights attached "to such part of the contract price as may remain in the possession of the government after the completion of the work by the contractors" and to funds paid over and deposited in a special account used only for the specific purpose of payment for labor and material. Here more than four months prior to bankruptcy the bankrupt contractor assigned to the surety all deferred payments, retained percentage, monies to become due under the contract and agreed with the surety that the latter be subrogated to the rights of the principal in the contract. The Court held that there was no preference voidable under Section 60 of the Bankruptcy Act, since amended.

Cox v. *New England Equitable Ins. Co.* (C. C. A. 8), 247 Fed. 955, involved the claims of a bank and other general creditors as against a surety who had paid materialmen and laborers and received an assignment of these claims as against a reserve which had been paid over to a contractor by mistake. The rights of judgment-creditors or of the trustee were not before the court.

Matter of Duncan (C. C. A. 3), 127 F. (2) 640, involved unpaid balances still in the hands of the Pennsylvania public authorities at the time of bankruptcy. The Court held that Pennsylvania law governed the case and it concluded that the surety thereunder was entitled to subrogation to the unpaid balance upon the contract, and the Trustee's standing as a judgment-creditor was "no higher than that of the bankrupt".

In *Moran* v. *Guardian Casualty Co.* (C. C. A. Dist. Col.), 76 F. (2) 437, the litigation was between the surety and the bank to a fund due by the United States to the contractor under a government contract. The funds were paid over by the government to a receiver appointed in the cause. The surety prevailed.

In *Matter of Zaepfel & Russell Inc.* (D. C. Ky.), 49 Fed. Supp. 709, aff'd sub. nom. *Farmers State Bank* v. *Jones* (C. C. A. 6), 135 F. (2) 215, the proceedings involved the respective rights of the surety and a bank as to the reserved portion of the contract. The question was as to which party was entitled to a priority over the other. The rights of the Trustee in Bankruptcy were not affected and the notation of appearances indicate that the Trustee did not appear.

In *U. S. Fidelity & Guaranty Company* v. *Triborough Bridge Authority,* 297 N. Y. 31, the issues were between the surety and the United States which had filed a tax lien for taxes owned by the contractor. The building contract provided that if the contractor failed to pay all laborers and materalmen, the authority had the right to withhold payments in an amount sufficient to pay same. The Court held the surety to be subrogated to the rights of the authority.

Century Cement Mfg. Co. Inc. v. *Fiore,* 264 App. Div. 475, involved the claims of a surety and an assignee of the contractor. The Court held that the surety was entitled to enforce its subrogation rights against the funds in the possession of the state exactly as the state would have been entitled to use this money as an offset if it had paid the laborers and materialmen directly.

Municipal Housing Authority v. *Hatfield Electric Corp.,* 264 App. Div. 99, 101, involved the claims of the surety and bank-assignee. The Court, after holding that the surety was subrogated to rights of the public authority, held that "the surety acquired the right of the authority to resort to the moneys retained in the hands of the authority to reimburse it for its outlay".

In all of these cases relied upon by petitioner the contest was over the funds reserved, percentages retained, or unpaid sums still in the possession of the government. This is not true in the instant matter. The fund here involved

was paid over to the bankrupt and deposited in its general bank account where it remained until subjected to the third party order. Petitioner cites no case which extends the rights of a surety to the situation present here. Nor is there merit to its additional argument that a judgment-creditor could not acquire a lien on the fund based on the contention that the bankrupt had no right to the fund and that the same did not belong to him except to the extent of any surplus that might remain after reimbursement of his surety. The petitioner is confusing the bases for the rulings of the Court in the aforementioned classes of cases, and is attempting to apply the rule applicable to surety completed contracts to contractor completed contracts. There are no cases cited holding that unpaid laborers and materialmen have legal ownership rights to the funds or hold rights as equitable assignees. All that is acquired is an equitable lien, but as stated in *Tobin* v. *Insurance Agency Co.* (C. C. A. 8), 80 F. (2) 241, 243:

> "An equitable lien does not constitute an estate or property in the subject of it, but is simply an encumbrance or charge upon such property, the legal title remaining in the creator of the lien."
>
> *In re Interborough Consol. Corporation* (C. C. A. 2), 288 Fed. 334, cert. den. 262 U. S. 752, 43 S. Ct. 700, 67 L. Ed. 1215.

In *Matter of Hutcherson* (C. C. A. 7), 133 F. (2) 959, the Court held that although a claimant held an equitable title to funds under an unrecorded assignment of a judgment under an Indiana statute, legal title thereto passed to the trustee, who could successfully invoke Section 60 of the Bankruptcy Act to defeat claimant's rights to the funds.

An equitable lien is good only as against the immediate party and third persons who are either volunteers

or take with notice. *Walker* v. *Brown*, 165 U. S. 654, 17 S. Ct. 453, 41 L. Ed. 865; *Zartman* v. *First National Bank*, 189 N. Y. 267. This rule was applied in *Martin* v. *National Surety Co.*, 300 U. S. 588, 57 S. Ct. 531, 81 L. Ed. 822. In that case a creditor agent of the government contractor collected monies due under the contract under a power of attorney from the contractor with knowledge of an agreement between the contractor and the surety whereby the proceeds of the contract became a fund to be devoted to the payment of the materialmen. The Supreme Court held that the equities in favor of the materialmen were impressed upon the fund so received and their interest was superior to that of the recipient. The *Martin* case is noted in *McKenzie* v. *Irving Trust Co.*, 323 U. S. 365, 65 S. Ct. 405, 409, 89 L. Ed. 309, with the comment that in the *Martin* case the subsequent assignee took with notice of an earlier assignment and as part of an obviously fraudulent scheme.

In the instant matter the equitable lien had not been perfected by the taking or acquiring possession of the fund prior to the service of the third party order or institution of the bankruptcy proceedings.

Several Courts have expressed applicable views as to the effect of the equitable lien on funds actually paid over to the contractor as present herein.

In *Kane* v. *First National Bank* (C. C. A. 5), 56 F. (2) 534, 535, 536, the Court stated:

> "We are not advised of any statute which requires that payments duly made to a contractor for public work be handled by him in any special way, or be given any particular application. No such contractual obligation appears in this case. In absence of statute or stipulation otherwise the general responsibility of the contractor is credited in contracting with him, and his general resources are

drawn on by him in executing the contract. Money or checks paid to him as the work progresses are the property of the contractor unincumbered by any trust, just as are payments to others for goods manufactured or services performed. The contractor's banker may receive such checks and is not bound to see to their application, nor to ascertain the state of the contractor's account with each contract; nor, if he knows it, need he govern himself in anywise with reference thereto. No wrong is done to the contractor's surety in recognizing the contractor's full title to such checks by taking them on deposit with the consequences ordinarily attaching to such deposit."

Third National Bank v. *Detroit Fidelity & Surety Co.* (C. C. A. 5), 65 F. (2) 548, cert. den. 290 U. S. 667;
Maryland Casualty Co. v. *Lincoln Bank & Trust Co.* (D. C. Ky.), 40 F. Supp. 782;
Fidelity & Deposit Co. v. *Union State Bank* (D. C. Minn.), 21 F. (2) 102.

In *Mack* v. *Colleran,* 136 N. Y. 617, the Court stated:

"It would lead to great embarassment, uncertainty and inconvenience if a person receiving money from a builder would have to ascertain whether he obtained it under a building contract before he could safely take it for property sold or apply it upon an antecedent debt justly due."

Under the cases above quoted, between July 6, 1942, the date when the fund was deposited in the bankrupt's account and July 14, 1942, the date of service of Grays' third party order the fund was the property of the bankrupt and could have been lawfully paid out to any *bona*

fide recipient or creditor without notice. It was subject, therefore, to the lien of the judgment-creditor and that of the trustee.

The fund could "have been levied upon and sold under judicial process against him (the bankrupt), or otherwise seized, impounded, or sequestered" under Section 70 (a) of the Bankruptcy Act (5) and thus passes to the Trustee under Section 70c of the Bankruptcy Act. (United States Code, Sec. 110, Title 11.)

POINT III.

No Special or Important Reasons Exist for Certiorari.

The decision of the Circuit Court of Appeals is not in conflict with the decisions of this Court, or of other Circuit Courts, or of New York Courts. The decisions relied upon by the petitioner did not pass upon the question presented in the case at bar (Point II, *supra*).

The decision of the Circuit Court below is of limited application, due to the facts presented, and is not of general importance. This is borne out by the fact that the question presented has been rarely raised although the Miller Act and its predecessor Acts have been in existence over a great number of years.

CONCLUSION.

It is respectfully submitted that the petitioner has shown no reason for granting its petition for certiorari, and the petition should be denied.

Respectfully submitted,

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